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In the Matter of

CC Docket No. 96-45

CC Docket No. 97-160

DA 98-715

of the

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**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of)	
)	
Federal State Joint Board)	CC Docket No. 96-45
on Universal Service)	
)	CC Docket No. 97-160
Forward-Looking Mechanism)	
for High Cost Support for)	DA Docket No. 98-715
Non-Rural LECs)	
)	

**COMMENTS
of the
RURAL TELEPHONE COALITION**

The Rural Telephone Coalition (RTC) files these comments regarding the Commission's methodology for determining universal service support in response to the Public Notice in the above-captioned proceeding. The RTC is comprised of the National Rural Telecom Association (NRTA), the National Telephone Cooperative Association (NTCA) and the Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO). Together, the three associations represent more than 850 small and rural telephone companies.

I. INTRODUCTION AND SUMMARY.

The RTC strongly supports the position recently taken by FCC Chairman William Kennard in his remarks to the United States Telephone Association (USTA) on April 27, 1998 concerning the success of rural telephone service under the traditional universal service mechanisms. The FCC's plans to implement a new federal high cost mechanism for non-rural telephone companies by January 1, 1999 are moving forward. As Chairman Kennard stated, there is no reason to make further rural company changes in this phase of this proceeding, let alone by the year originally-posited, 2001.

Congress decreed that universal service support must be sufficient, specific, and predictable. Any universal service mechanism that does not meet all three of these conditions is not acceptable under the 1996 Telecommunications Act.

The RTC approves of the fact that rural companies are not necessarily covered in the proposals under discussion, and submits these comments due to the important role played by universal service mechanisms.

The RTC raised various issues in a Petition for Reconsideration and Clarification of the Commission's Universal Service Order in July, 1997, that have yet to be addressed. The Petition sought to remove the "interim" cap on the Universal Service Fund, eliminate the Order's acquisition penalty and allow disaggregation of transitional portable support.

Proposals based on proxy models cause concern due to the punitive manner in which such models treat rural carriers and their subscribers. Proposals that would require states to furnish the majority of federal universal service support, with federal contributions existing as a backstop, do not reflect the law passed by Congress. Nor do plans that seek to minimize the flow

of funds between high cost and low cost states. Statutory high cost requirements cannot be disregarded. High cost support is not intended to address cost discrepancies. The goal of universal service is to provide support to rural and high cost areas; the goal is not to reduce access charges.

II. THE CHAIRMAN'S PLAN TO EXCLUDE RURAL TELCOS FROM ANY SIGNIFICANTLY-ALTERED UNIVERSAL SERVICE IMPLEMENTATION MECHANISMS ADOPTED HERE COMPORTS WITH SECTION 254 AND THE INTENT OF CONGRESS.

The RTC strongly supports the Chairman's position. In his recent remarks, the Chairman said that:

When it comes to our country's smaller, rural telephone companies — companies that serve one-third the nation's geography but only about 5% of the population — if it ain't broke, don't fix it I visited a small rural telco not too long ago and what I saw was a first-rate telecommunications operation. I didn't see anything that was broken and I had no desire to offer any fixes. The Commission has already taken explicit small company support, changed the way the support is collected to be consistent with the 1996 Act, and made that support portable between competing carriers. That's a lot of change for companies that are geographically very targeted and undiversified.

My bottom line is that universal service reform is something the Commission should do with small rural carriers, not to them. The Joint Board will soon appoint the Rural Task Force, which I fully support as a means of developing a greater consensus on what further actions, if any, must be taken for universal service support to high cost areas served by small companies. But I want to be clear on this point — I see no reason why further small company reform must begin in 2001. We should make changes only when it is right to make changes, and not before.

As the Chairman's experience indicates, a visit to a rural telephone company will reveal the dramatically different circumstances confronting small and rural companies providing universal service to less densely settled areas, without large metropolitan areas to provide

economies of scale. It is fully consistent with the mandates of the 1996 Telecommunications Act (the Act) as a whole, and of Section 254 of the Act in particular, that the Commission maintain the current transition plan for rural telephone companies “essentially unchanged” from the pre-Act support plan.¹

In fact, any change to a new plan that had not been thoroughly evaluated, validated for use in rural telco areas and observed in operation in non-rural company areas would be contrary to the dictates of the sound public policy enacted in Section 254, which articulates the principles to govern the advancement of universal service. It mandates — as a national commitment — “sufficient,” “specific” and “predictable” federal support to achieve “quality” service at “just, reasonable and affordable rates,” as well as “reasonably comparable” rural and urban rates, and service and access to advanced telecommunications and information services for all regions of the country. Rural telecommunications service providers have made great and continuing progress toward meeting these goals under the present support system, as reported by Chairman Kennard, above, and observed in his rural telco visits.

The established universal service arrangements, which should be maintained, have proven to be “sufficient” under past conditions to enable rural telcos both to provide evolving services to their customers and to modernize their networks.² Hence, the efforts of several of the proponents of the plans under study here to fashion interim “hold harmless” support flows for rural

¹ See, Common Carrier Bureau Request for Comments, DA 98-848 (released May 4, 1998) p. 2.

² According to the National Exchange Carrier Association’s (NECA) 1997 Access Market Survey of NECA’s Traffic Sensitive Pool members, more than 57% of central offices and 68% of customer access lines have access to SS7 features. This reflects growth rates of 25% in central offices and 18% of lines over the 1995 survey. The survey also shows that 98% of access lines can utilize digital switching features.

providers³ constitute good policy. However, most plans have not yet recognized that the record is devoid of information that could support a finding that ensures rural LECs would receive “sufficient” support to allow them to offer to their customers rates and service levels that will be “reasonably comparabl[e]” to urban rates and services throughout the nation. Similarly, most plans have yet to ensure that there will be adequate incentives for rural networks and services to evolve and keep pace with advances. Comparability of both price and service offerings are equally important goals to Congress.

With the exception of the cap imposed in 1994 and unlawfully carried forward after passage of the Act, the established universal service arrangements, largely retained by the Commission’s Rural Transition Plan, also embody a specific and predictable cost methodology and support framework shaped by practical experience and implemented through jurisdictional separations. The result has been to shift far more than the 25% base interstate allocation of LECs’ loop costs. Moreover, using jurisdictional cost allocations procedures to advance nationwide service aims has received a judicial imprimatur,⁴ passing muster because the procedures are neither a tax nor an unlawful welfare program. The courts have reiterated that there is no simple economic answer to dividing responsibility between state and federal authorities: “There is no purely economic method of allocation...elements of fairness and other noneconomic values inevitably enter the analysis of the choice to be made.”⁵ That legal track record is particularly important now, with challenges already mounted on the basis of claims that

³ For example, the RTC particularly appreciates the commitment of the Ad Hoc Plan designers to ward off disruptive support losses for rural universal service providers for at least four years.

⁴ Rural Telephone Coalition v. FCC, 538 F. 2d 1307 (D.C. Cir. 1988) (RTC v. FCC) quoting MCI Communications Corporations v. FCC, 675 F. 2d 408, 416 (D.C. Cir. 1982)

⁵ RTC v. FCC, at 1314

the Commission's mechanisms and the 1996 Act itself constitute an unlawful tax measure.

Texas Office of Public Utility Counsel, et. al., v. FCC, Case No. 97-60421, (5th Cir., docketed June 25, 1997). Some confidence that the chosen federal mechanism will be sustained if challenged is essential to maintain the incentives to upgrade rural networks that Congress intends. For the same reason, prudence should dictate against converting the federal support mechanism into a state block grant program, a drastic change with enormous legal risks.

The Rural Transition Plan does not apply the unlawful 25% federal support share to rural telcos but looks at actual costs, at least for incumbent rural companies. So far, no forward-looking proxy cost plan has emerged that could reasonably be characterized as providing "sufficient," "specific," or "predictable" federal support to prevent increases in (a) rural rates, (b) rates in particularly rural states, or (c) support mechanisms in states without extensive low cost urban populations. Such increases threaten to destroy the reasonable rural and urban rate and service parity the law demands.

While the RTC takes no position on how to ensure that the rural areas served by non-rural carriers are served according to the statute, the "bifurcation" between rural and non-rural telcos is consistent with the Act's separate definition and safeguards for rural telephone companies. Sections 3(37); 214(e); and 251(f) of the Act, among others, recognize that rural differences warrant separate consideration. Such bifurcation in universal service proceedings is reasonable, and is consistent with the Act's recognition that regulation of rural carriers must reflect their different circumstances.

III. ENSURING SUFFICIENT SUPPORT CANNOT BE CONTINGENT ON THE STATUS OF OTHER SECTIONS OF THE ACT.

AT&T's March 6, 1998 testimony suggests that the Commission should delay the transition to the cost proxy methodology for determining support for major ILECs until these companies have opened their markets to robust and widespread local competition. Sections 271 and 251 are the statutory tools for implementing local competition and checking Bell Operating Company (BOC) entry into the interexchange market. The Act unconditionally requires "sufficient" support and a plan to arrive at sufficient support. While the transition to cost proxies may be appropriate for other reasons, a complete delay to accomplish the goals of Sections 251 and 271 is not contemplated by Section 254. The Commission can certainly take steps to promote competition, but it has the obligation to establish mechanisms that comply with the principles of Section 254 and promote universal service even if its implementation of Sections 251 and 271 is frustrated.

IV. WHILE REFRAINING FROM CHANGING THE FEDERAL SUPPORT MECHANISMS FOR RURAL TELCOS, THE COMMISSION SHOULD GRANT THE RTC'S LONG-PENDING PETITION FOR RECONSIDERATION OF THE UNIVERSAL SERVICE ORDER.

While it is sound policy to maintain the rural telco transition plan, the Commission should not ignore pending requests to improve and rectify certain errors in the transition plan. Ten months ago, on July 17, 1997, the RTC submitted its Petition for Reconsideration and Clarification of the Commission's Universal Service Order (the Petition). In the Petition, the RTC addressed several issues pertinent to the transition that remain important to its members. The Commission has not addressed the arguments in the Petition. Even though this proceeding is limited to non-rural companies, we believe a reminder and renewed request that the

Commission grant the RTC's Petition with respect to the rural transition determinations in the universal service proceeding are justified.

First, reconsideration should remove the indexed cap to eliminate an unlawful barrier to sufficient transitional support.⁶ The Universal Service Fund (USF) cap is an arbitrary rule which unlawfully prohibits legitimate growth of the fund once a certain level is reached, without regard to its "sufficiency." With the indexed cap, it is impossible to predict future levels of support, as required by the Act. If the average cost per loop is increasing more than the cap allows for, as when a number of companies upgrade or replace important network components to enable their customers to enjoy up-to-date services and technology, the cap begins to shortchange all high cost rural ILECs, rather than providing the "specific" level of support justified by their high costs. Although the fund is increasing -- for entirely legitimate reasons -- consistent with the intent of Congress in enacting Section 254, the cap will exclude support for reasonable costs incurred in high cost areas, to the detriment of these subscribers. The cap was initiated in January 1, 1994, and had only been in place for two years prior to the adoption of the 1996 Act. The Commission now plans to extend it indefinitely until forward-looking economic cost mechanisms are developed and put in place. This process will not be completed for rural ILECs until at least January 1, 2001, and the Chairman has wisely acknowledged that there is no reason to regard that date as a deadline. Thus, unless relief is granted, an arbitrary cap that was intended to be an "interim" measure will remain in effect for at least seven years, no matter how insufficient it makes the transitional federal support.

⁶ The RTC commends the Ad Hoc proposal advocates for supporting continuing recalculations under the preserved rural mechanisms throughout the transition, without an arbitrary cap.

Second, reconsideration should remove the acquisition penalty adopted in the May 8, 1997 Universal Service order, which denies sufficient transitional support to customers whose serving areas are sold. There is no legal or public policy support for the Commission's decision to limit federal universal service to carriers that purchase exchanges after May 7, 1997 to the same level of support per line for the acquired lines that the seller received prior to the sale. The Commission surmised that freezing support for acquired lines would discourage carriers from placing unreasonable reliance upon potential universal service support until it applies forward-looking economic costs to calculate support for all buyers. This unsupported surmise by the Commission will discourage acquisition by small and rural LECs that would have improved service in neglected exchanges they purchased, even though rural infrastructure modernization is consistent with national universal service goals. The freeze on support unlawfully robs customers in the affected areas of the predictable, specific and sufficient support that the Act prescribes.

Third, reconsideration should remove the bar on disaggregation of transitional portable support because it denies sufficient, predictable and specific support to incumbent rural telephone companies and provides windfalls for uneconomic competitive LEC (CLEC) competition. The problem with forbidding disaggregation during the transition is that it invites uneconomic entry into high cost areas by a CLEC that cherry-picks the serving company's most profitable business and leaves it with the highest cost remaining customers. It must be remembered that costs vary among the denser and less densely populated segments within study areas, even for LECs with high average costs. If a competitor serves a high cost LEC's hub town, where costs are the lowest, with lower cost facilities, the CLEC will get excessive support

for customers it attracts in the dense area. The CLEC's support will be based on the rural LEC's average cost for serving the whole area. At the same time, the incumbent LEC will lose the customers whose lower costs kept its average study area support from reflecting only the higher costs of serving sparser parts of the area. The CLEC need not even incur the high costs for serving the ILEC's remote, high cost customers, since it can do so by reselling or offering to resell the ILEC's subsidized service to its higher cost locations. Hence, the Commission's decision to "calculate a CLEC's per-line support by dividing the ILEC's universal service support payment by the number of loops in the ILEC's most recent annual loop count," (Universal Service Order, ¶ 312), ignores demonstrated rural service dynamics and cost structures and actually undermines universal service throughout entire study areas.

V. WHILE PROPERLY EXCLUDED FROM PROPOSALS EVALUATED HERE, RURAL COMPANIES HAVE A VITAL INTEREST IN HOW THE COMMISSION INTERPRETS AND APPLIES THE LAW AND ECONOMIC THEORY FOR NON-RURAL TELCOS.

The RTC has a continued interest in the outcome of universal service mechanisms, even though -- appropriately -- the mechanisms under consideration here may not apply to rural telcos.

Some plans include, or may include, rural ILECs, and the Commission has previously made statements to the effect that it will ultimately apply a forward-looking cost proxy to rural telcos.

Once the precedent of the mechanism for non-rurals is set, it will be more difficult for rural telcos to change the course of the Commission's thinking when it turns to rural policy issues.

Moreover, the Commission will need to interpret the 1996 Act and deal with economic theory issues to finish implementing any of the plans before it.

The RTC has participated in the legislative and implementation processes and has given a great deal of thought and study to these questions. We intend to participate here to help in the resolution of questions that are not strictly "rural" or "non-rural," but will inevitably affect future Commission thinking about rural mechanisms. Therefore, we ask that the Commission consider the RTC's position on these issues even though the current proceeding has quite properly excluded its members from immediate impact. We therefore also identify several elements of various proposals, some intended to apply to all ILECs, that we believe depart from the statutory universal service mandate.

VI. THE PROPOSED FORWARD-LOOKING COST METHODOLOGY POSES SERIOUS PROBLEMS FOR ALL COMPANIES, PARTICULARLY FOR RURAL TELCOS.

The Commission has proposed that the determination of universal service support generally be based upon forward-looking cost proxies designed to predict the cost that an ideally efficient new carrier would incur in building a network to serve all the customers in a given geographic area.⁷ Such a method fails to account for much of the cost already incurred in the build-out of a telephone system in areas that would likely not have "quality service" -- or perhaps any service -- if the marketplace alone had controlled the past development of the public switched network. The use of such a cost system is particularly punitive to rural companies, where the cost of build-out has been extremely high. Indeed, for many rural companies, the inability to recoup their real world investments and expenses will prevent the funds they receive from the USF from passing the Act's three-pronged sufficient, predictable and specific test. It is equally important to avoid stifling investment in network modernization. Without knowing what

⁷ Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Report and Order (released. May 8, 1997), (Universal Service Order).

changes forward-looking cost updates will wreak in support, the incentive to invest in ongoing network and service modernization is harmed. This investment incentive must be grounded in confidence that the company and its lenders will have a reasonable opportunity to recover the investment and make a reasonable profit.

Most of the proposals that have been submitted assume a forward-looking cost model. The use of Forward-Looking Economic Cost (FLEC) models is appropriate only so long as the Commission explicitly recognizes that the suitability of forward-looking costing for non-rural companies, and its suitability for rural companies, are entirely unrelated because of the enormous differences among rural companies. Forward-looking costing has not been shown to account for the diversity of rural companies and conditions. Even U S West, a major designer and advocate for forward-looking models that has spent millions of dollars and thousands of person-hours in developing a cost proxy model, says (Attachment II, p. 3) that it will be necessary to conduct several years of hands-on experimentation with forward-looking cost models as applied to non-rurals before the method could responsibly be applied to a rural telco.⁸

Another impediment to finding a plan based on a FLEC proxy model that satisfies the mandates of Section 254, even for non-rural LECs, is that there is no way to price out a plan to see if it is “sufficient” or to judge whether rates and services will be affordable and infrastructure modernization incentives positive. Proposals that attempt quantification based on a FLEC

⁸ The Ad Hoc proposal is flawed in that it does not even differentiate between rural and non-rural areas. However, the Commission has expressly recognized that rural differences necessitate more rigorous testing for any proxy model’s validity and reliability.

assumption, such as the Ad Hoc proposal (p. 5), recognize that any results are necessarily no more than illustrative as long as the cost methodology is undetermined.⁹

VII. THE COMMISSION MUST NOT ADOPT APPROACHES TO FEDERAL SUPPORT MECHANISMS BASED UPON IMAGINARY NATIONAL SUPPORT FLOWS FROM STATE TO STATE INSTEAD OF THE EXPRESS STATUTORY TERMS.

Several of the plans, including the “floating benchmark,” “floating percentage” and Ad Hoc plans, seek to obtain consensus based on balancing the “ability” of high and low cost states to provide support internally.¹⁰ Some suggest looking at state averages compared to national cost averages to make such comparisons.

Although the Ad Hoc Working Group offers a five-step plan meant to bridge the gap between different federal and state universal service policy initiatives, its alternative approach creates a system of “payer” and “receiver” states. By basing the determination of federal support levels on the proposed state-average costs (p. 17), the Ad Hoc plan effectively substitutes an imaginary state-to-state exchange of funds for the federally mandated national support mechanism. The design therefore lends itself to a discussion of state “winners” and “losers,” though there exists no legal rationale for a federal universal service subject to the interests of low- and high-cost states. The Commission should not allow the principle of “reasonably comparable rural and urban rates” to be transformed into a state-by-state comparison of each

⁹ BellSouth’s proposal also relies on a yet to be selected “reasonable cost proxy model.” It is simply not known whether any of the models that are being developed will identify economic costs for all carriers evenly or appropriately.

¹⁰ For example, the Colorado Public Utilities Commission (PUC) and the South Dakota PUC each offer for comment plans involving variable benchmarks to replace the two static FCC-proposed national benchmarks: one for residences and one for businesses. One of the means they suggest for varying the benchmark is each state’s ability to support high costs within the state.

state's average to the national average, with state discretion over any within-state support for comparability.

The Ad Hoc plan includes a "hold-harmless" measure to ensure that federal support for a state will be no less than the amount currently received by carriers in that state (p. 17). The RTC supports this goal and commends the group's intent to include high transport costs (at least when combined with high loop and switch costs). Yet because the Ad Hoc Working Group's proposal to calculate on a state-average basis significantly differs from the Commission's wirecenter-by-wirecenter approach, without the hold-harmless provision, the highest-cost states could receive *considerably* less support under the Ad Hoc plan than they would via the Commission's current transition mechanism. For this reason, the "hold-harmless" provision is absolutely critical to the proposed plan. At the same time, the RTC believes that provision renders the imposition of an alternative mechanism unnecessary. The Commission has already adopted an appropriate Rural Transition Plan.

VIII. THE ACT CONTAINS NO INSTRUCTIONS OR AUTHORITY TO REQUIRE STATES TO ALTER OR REBALANCE RATES.

Some plans (such as those proposed by Sprint, U S West, and GTE) support rate rebalancing at the state level. However, Commissioner Harold Furchtgott-Roth accurately noted in his dissent to the Commission's recent Report to Congress that any such requirement is beyond the Commission's authority. As Commissioner Furchtgott-Roth stated, "[The Commission] should have made sure that states understand that this Commission does not -- and

indeed in my opinion it cannot -- require [states] to rebalance or alter their local rates in any way prior to receiving additional federal universal service support.”¹¹

No plan should require states to rebalance rates. Nothing in the Act gives the Joint Board or the Commission such power.¹² If a mandate to keep funding within state boundaries as far as possible results in a larger intrastate support obligation for any state, customers in that state would face higher rates, which is exactly the opposite effect Congress sought when the Act was passed. Further, any federal directive which leaves any state no choice but to alter rates would constitute an unfunded mandate, which Congress has expressly forbidden.¹³

The RTC does not intend to suggest that the federal support mechanism will be substituted for the existing state universal service mechanisms and implicit flows. The Act does not direct or authorize the Commission to require the states to address their implicit support flows until they choose to or are prompted by marketplace developments to do so. There is no need to determine if additional federal support is necessary to deal with state modifications to implicit support at this time, although if the Commission were to order or condition federal support on such state modifications, the federal mechanism should certainly make nationwide high cost recovery available for the federally-ordered changes. In any event, Section 254(f) indicates that any adjustments states make must not burden the federal support mechanism, thus,

¹¹ Dissent and separate statement of Commissioner Harold Furchtgott-Roth, *FCC Report to Congress, In the Matter of Federal-State Joint Board on Universal Service*, Adopted and Released April 10, 1998.

¹² The fact that the Ad Hoc proposal relies upon a mandatory state role (p. 27) within the federal universal service mechanism is, itself, a cause for concern. Although Section 254(e) requires that federal support be explicit, state plans are discretionary under Section 254(f). The Commission has already renounced responsibility for whatever state implicit support is made explicit, unless after monitoring it chooses to increase the federal share, and there is simply no legal basis for exacting mandatory state participation in funding its federal mechanism for high-cost support.

¹³ 2 U.S.C. 1501, et. al.

the states' existing implicit and explicit support responsibility is preserved, regardless of how they decide to tailor such support to the conditions in their individual states.

While state involvement in the design of the federal definition and support mechanism is required by the joint board provision in Section 254(a), the Joint Board and the Commission must both apply the statutory standards for federal support, including sufficiency, specificity, and predictability of support, as well as affordable and reasonably comparable rates, services and access to advances for rural and urban customers. Those standards simply do not permit the substitution of a standard based on imaginary flows in the nationwide support from state to state. The criterion of comparability alone bars such a redirection of focus. Indeed, the entire concept of a national universal service support policy, mandate, definition and federal mechanism is grounded in the economic recognition that each connection to the nation's public switched network benefits all users, so that a national shouldering of responsibility for recouping the high cost component is sound policy and economically justified.¹⁴

Thus, the FCC's 25% proposal and the various state-balancing proposals share the problem of substituting an extraneous standard for the mandates Congress specified in the 1996 Act. None will achieve the national and uniform universal service objective of the Act. So long as the method adopted allows the FCC to pick up a mere 25% of the total support, there can be no true national universal service. States will, as both the Colorado and South Dakota Public Utility Commissions (PUCs) point out, behave differently from one another. As John Staurulakis, Inc. (JSI) sets forth in its comments, the system proposed by the FCC will result in 50 different universal service programs. A state's ability to reach the goals of universal access at

¹⁴ John C. Panzar and Steven S. Wildman, Competition In The Local Exchange: Appropriate Policies to Maintain Universal Service In Rural Areas.

reasonable rates will vary depending on that state's ability to make up the gap left by a lack of federal support. The RTC agrees with JSI¹⁵ that the FCC's decision to make states responsible for 75% of "federal" universal service support is contrary to Section 254(b) of the Act and discriminates against customers in states with large rural populations.

While the state-balancing proposals attempt to ameliorate this inequity by turning the national benchmarks into variables, and thus try to even out the benefits to less-urban states, they still seek to satisfy interests that are at odds with the statute and Congress's intent. Cost and inconvenience to consumers, carriers and governments alike must also be considered. It stands to reason that if a multitude of states are required to undertake a complex regulatory task such as rebalancing, the effort will burden both carriers and governments. Subscribers and taxpayers will ultimately bear the costs. Neither consumers nor carriers are helped if efforts to keep federal support levels as low as possible have the result of even higher regulatory and support costs at the state level. As long as the cost recovery approach for the federal mechanism is not a national one, the results will be inequitable, regardless of well-intentioned back-door attempts to re-configure the formula.

IX. THE FOUR APPROACHES MODELED BY THE TELECOMMUNICATIONS INDUSTRY ANALYSIS PROJECT BEGIN THE PROCESS OF QUANTIFICATION THAT IS NECESSARY TO EVALUATE UNIVERSAL SERVICE ALTERNATIVES, BUT LARGELY IGNORE THE STATUTORY HIGH COST REQUIREMENTS.

The Telecommunications Industries Analysis Project (TIAP) submitted hypothetical price-outs for four approaches and some variations. Each alternative, like the proposals discussed

¹⁵ RTC submitted a similar argument in its Petition for Reconsideration and Clarification of the Commission's Report and Order on July 17, 1997.

above, is an attempt to ameliorate the damage that would result if the FCC were to support only 25% of the USF. In the first option studied, the Modified Plan, TIAP proposes a change from 25% federal and 75% state support to 40% federal and 60% state support. The RTC agrees with the direction this is headed, but even an increased federal percentage is not the proper tool for implementing sufficient support to accomplish what Congress directed. Even a percentage split like this one will leave the residents of some states with far greater residual intrastate costs to absorb in their rates than a plan under which the federal share of high cost recovery is in keeping with the national responsibility Congress gave it.

TIAP's second price out, a Density Zone Plan, assumes that for areas with densities between 0 - 5 lines per square mile (and maybe also 5 - 1000 lines per square mile), the federal support would be 100%. This option moves the ball in the right direction, by focusing on the vast differences between rural areas and well-populated ones, but still addresses only a fraction of the high cost problem by allowing the federal jurisdiction to pick up its share for only these two low-density areas, with no way to tell if the result meets the statutory criteria.

TIAP calculates hypothetical impacts for a third alternative, using numbers of lines as the unit of collecting support directly from customers. This option has the merit of assuming 100% federal support. But it would have a regressive impact in shifting much more of the high cost burden onto residential and small business customers, to the benefit of high volume toll customers.

TIAP's fourth price out calculates one nationwide surcharge that each carrier would include on each of its customer bills. The surcharge would be calculated by dividing the fund by total annual retail revenues. Again, this option assumes 100% federal support, and the RTC

agrees with that aspect of this alternative proposal. The result would be equitable, competitively neutral and explicit at even the customer level.¹⁶

Overall, none of the TIAP options that the Commission has not already rejected would go far enough toward achieving the universal service promise of the Act for the Commission to find on a record that its federal mechanism would accomplish the tasks the statute assigned to it. Only a truly national, federally-funded program will ensure that residents of every state and every rural area receive affordable, comparable and equally technologically-advanced service as required by the Act.

X. HIGH COST SUPPORT IS INTENDED TO ADDRESS COST DISCREPANCIES, NOT INCOME DIFFERENCES.

The proposal by Time Warner Communications Holdings, Inc. (TWComm) mischaracterizes the Commission's policy of support for high cost areas, implying that the decision to base subsidy levels for schools and libraries on the relative wealth of the school or library and the Lifeline and Link Up programs should be extended to high cost support. The Act contains separate provisions that address these programs and, in the case of Lifeline, direct the Commission to consider not "income" as TWComm suggests, but access for "low-income" consumers.¹⁷ In the case of the E-rate, student income guidelines may well be the best method of achieving the goal of connecting classrooms and libraries across the Nation. Local control and funding for these public institutions has created huge disparities in the resources available to schools and libraries and available funding is disparate and based on the wealth of particular school districts. Further, administrative efficiency is promoted by income-based criteria that are

¹⁶ The RTC is aware that the Commission rejected the surcharge proposal in the May 8, 1997 decision.

¹⁷ Section 254(b)(3)

well documented and already are the basis for various types of federal funding to schools and libraries.

The telecommunications nationwide network, on the other hand, is uniformly of a high quality and ubiquitously deployed precisely because a national universal service policy has until now ensured that the carriers who provide the infrastructure for this national system receive the support they need to make the investments necessary to maintain the network. TWComm misses the point that the “affordability” of rates provided for in Section 254(b)(1) is a separate and distinct requirement from urban-rural rate “comparability” which must also be considered in developing support mechanisms.¹⁸ The Act directs the Commission and Joint Board to base their universal service decision on the principle that rates for services in high cost areas must be “reasonably comparable” to rates in urban areas and consumers in those areas should have comparable rates and access not just to federally supported services but to “telecommunications services and information services, including interexchange services and advanced telecommunications services and information services.”¹⁹ TWComm’s suggestion that the states should decide whether to support high income areas completely ignores the distinction between the states’ authority to set intrastate and local rates at “affordable” levels as part of their rate making authority and the Commission and Joint Board obligation to enact regulations that ensure “comparable” urban\rural rates as well as “sufficient” support.²⁰ The “comparability” and “sufficiency” requirements of the Act are not nullified by the fact that income levels and wealth

¹⁸ The Act does not require or even suggest that low-income support should, in effect, incorporate support for high-cost areas. Indeed, Section 254(j) indicates that Congress was satisfied with the existing low-income support mechanism.

¹⁹ Section 254(b)(3)

²⁰ Sections 254(b)(3) and (4)

are permissible factors that the states can consider in determining whether intrastate rates are affordable.

TWComm's proposal is misleading for other reasons. It uses Basic Cost Model 2 (BCM2) which has not been validated to show examples of per-line subsidies to households with high median incomes. It also uses BCM2 to show subsidy flows and supposed savings. These savings should not be viewed as credible since BCM2 has been neither validated nor adopted as the measure of costs that will be funded.

Without explaining how it would determine cost based rates, TWComm also makes sweeping statements that consumers in the top 30% income levels are able to pay cost based rates. Without knowing what the costs are, whether embedded or economic, it is impossible to determine what percentage of any household's income will be required to pay for the federally defined services. Subscribership and access for these customers will be adversely affected by this plan. Universal service in high costs areas will also be affected adversely. To the extent that any carrier loses support for any Census Block Group that fits the criteria, the ability to serve all customers in the service area is affected.

XI. THE ACT DOES NOT CONTEMPLATE THAT THE FEDERAL UNIVERSAL SUPPORT SHOULD BE USED TO REDUCE OR ELIMINATE ACCESS CHARGES.

Although BellSouth takes the correct approach in proposing that both interstate and intrastate revenues should be assessed, it assumes that the Common Carrier Line (CCL) and Presubscribed Interexchange Carrier Charge (PICC) revenues recovered from IXC's for access represent implicit support. It proposes that carriers use support to offset lost CCL and PICC revenues. In the Access Charge decision, the Commission said it intends to determine how

ILECs must reduce their access charges to reflect universal service support received from the new mechanisms. Its decision was premised on the notion that it would fund only interstate costs and that those costs were 25%.

The Commission has now repudiated its position and indicated that it will revisit the decision to limit funding to 25%. That review will necessarily involve a review of the decision to limit the benefits of federal support to reducing access charges. In any event, support is intended to preserve and advance universal charges, not reduce or eliminate any or all the elements of access charges. The principles enumerated in Section 254 are intended to benefit the consumers of telecommunications services. BellSouth's proposal incorrectly assumes that interexchange carriers are the intended beneficiaries of universal service. The proposal should be rejected.

XII. CONCLUSION

For the foregoing reasons, the RTC respectfully urges the Commission to maintain the transition plan for rural ILECs and to allow rural telephone companies to do, unimpeded, what they do best: serve their local rural customers. The RTC further urges the Commission to

reconsider its Universal Service Order and adopt the improvements in the transition plan that the RTC supported in its Petition for Reconsideration.

Respectfully submitted,

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